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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

C. C. COOKE,
Petitioner,

VERSUS

COMMISSIONER OF INTERNAL REVENUE,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT AND SUPPORTING BRIEF

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May, 1953.

UTTERBACK TYPESETTING CO., 13 SO. WALKER, OKLAHOMA CITY, PH. FO 8-8780

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No. .....

Supreme Court of the United States

OCTOBER TERM, 1952

C. C. COOKE,
Petitioner,

VERSUS

COMMISSIONER OF INTERNAL REVENUE,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

To the Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

C. C. Cooke, by his attorneys, John H. Cantrell and Edward M. Box, prays that a *writ of certiorari* issue to review the judgment of the United States Court of Appeals for the Tenth Circuit, affirming the judgment of the Tax Court of the United States in the respects and to the extent hereinafter noted.

OPINIONS BELOW

The memorandum Findings of Fact and Opinion of the Tax Court (R. 25-77) was entered September 13, 1951 (R. 77), and is not reported. The judgment of the Court of Appeals sought to be reviewed (R. 555-562, 597) is reported at — F.2d —.

JURISDICTION

The judgment of the Court of Appeals was entered on January 3, 1953 (R. 555). A Petition for Rehearing, filed on February 18, 1953, was denied on April 14, 1953 (R. 602). The decision and opinion of the Court of Appeals in denying the rehearing sought appears in the record at pages 601-602. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254.

QUESTIONS PRESENTED

1. Is an oral contract between an employer and his key employees valid, enforceable and reasonable when it provides for profit-sharing in the first future profitable year—fifty per cent to the employer and fifty per cent to the employees collectively—upon consideration that they stay with him at their then wages and help him hold his business together, and which contract is fully performed?

2. When such contract has been established and its performance proved by the uncontradicted evidence of the employer and the employees, can the Tax Court disregard this evidence and disallow otherwise authorized tax deductions upon the basis that the contract was non-existent and unenforceable?

3. Is it not reversible error *per se* in a tax case for the Court of Appeals on review to refuse to consider and pass upon the issue of a claimed credit on account of taxes paid where that issue was made *in limine* and insisted upon throughout?

STATUTES INVOLVED

The statutes primarily involved are: Internal Revenue Code, Secs. 22, 23: Oklahoma Statutes 1941, Title 15, Secs. 70 and 75. Treasury Department Regulations involved are 103 Sec. 19.23 (a)—6, 19.41—1, and 19.43—1. The pertinent parts of those statutes and regulations are set out in the Appendix hereto.

STATEMENT OF THE CASE

This case involves income tax deficiencies, assessed by the Commissioner, for the years 1941, 1942 and 1943 (R. 11-20). The Tax Court reassessed deficiencies for 1941 and 1943 at $46,239.86 and $70,995.51 respectively (R. 87). These amounts were actually the result of disallowance of an employer-employee profit-sharing contract covering the years 1936-1942 and profits shared in 1941 and 1942. The reversal shown by the opinion of the Circuit Court as to the partnership issue will not materially affect the amount of the 1943 deficiency assessment upon recomputation. Petitioner was on accrual basis (R. 114). The Court of Appeals for the Tenth Circuit affirmed the judgment of the Tax Court upon the profit-sharing in its entirety while reversing the Tax Court upon the partnership issue which is not now involved.

To save his business organization (R. 207, 214-215) and to weld it together at a time when he could not pay wages and salaries adequate to do this otherwise (R. 201-215, 205), and before the services were actually rendered, petitioner made commitments to his key employees to share profits with them on a 50-50 basis (R. 207, 205-215) for the

first future profitable year (later determined by modification agreement in 1940 to be 1941 and 1942), if they would stay with him, keep his organization together and help produce the prospective profits (R. 207-210, 177).

Petitioner kept this agreement (R. 109-120), as he was obliged by Oklahoma law as well as morals and good business judgment to do, and the amount thus paid to his key employees was either a bona fide business expense incurred in and thus deductible for 1941 and 1942, under Title 26, Section 23-(a)-(1)-(A) of the Code, or in true substance a joint adventure for profit-sharing which would make the profits taxable to those who received them.

Petitioner is an unlettered self-made man, as are three of the employees involved in this controversy (R. 230, 204-208). Without benefit of legal counsel, practical business necessity and judgment dominated the course of events (R. 214-215, 219-220). The absence of astuteness, cunning, cleverness, ulterior purpose, regularity, uniformity and "cover-up" proclaims genuineness (R. 50, 51, 52, 54, 57, 77).

Petitioner believes the uncontradicted evidence established the following facts: The first commitment for profit-sharing was made to Ground in the presence of Hodges in 1936 (R. 207, 163, 159). Subsequent commitments of similar kind were made to Hodges, Cooke, Jr., and DeLaughter between 1936 and the end of 1940 (R. 101-106, 163, 175). These commitments were made by the employer in the exercise of his best judgment and in the good faith, belief and determination that they were necessary to carry on his business (R. 215, 225-226). Such com-

mitments, under the circumstances, were necessary, customary and required (R. 245, 237-238, 249-250, 261-262).

In 1936, learning that he was about to lose one of his key employees, J. P. Ground, who was dissatisfied with the wages being received, Cooke promised that if Ground would remain with him and help him hold the business together, he would share profits with Ground in the first subsequent profitable year (R. 207, 163). The other key employees heard or learned of this commitment and it was subsequently extended to include them (R. 101-106, 163, 175). They stayed on the job and worked for C. C. Cooke, doing business as C. C. Cooke Company, through the years up to and including 1942. In 1940, beginning in July they received assurances for the profit-sharing in that year (R. 106-107, 159-160, 163). By subsequent agreement in 1940, 1941 and 1942 were substituted for the profit-sharing in lieu of 1940 (R. 105, 179, 163, 209).

These were extraordinary employees (R. 257-261, 250-257), their services being essential to the employer and being extraordinarily valuable (R. 215, 244, 240, 214). 1940 was the first profitable year (R. 105, 163, 179, 209) but by general agreement the employer was permitted to retain the profits for that year to get himself out of debt (R. 105, 163, 179) and in lieu of sharing with the employees in that year definitely promised to share the profits "50-50" with them for the years 1941 and 1942 (R. 105, 163, 179, 209). The profits were shared in each of these years, the division of the 50 per cent to the employees being upon percentages mutually acceptable (R. 109, 118-120).

For 1941 the division was 50 per cent to Cooke, Sr., 20 per cent to Ground, 20 per cent to Cooke, Jr., and 10 per cent to Hodges (DeLaughter having agreed to delay his sharing in the profits until 1942 since he had not been with Cooke as long as the others) (R. 109-111, 445). The profits for 1942 were subsequently split with 50 per cent going to Cooke, Sr., 20 per cent to Cooke, Jr., 20 per cent to Ground, 5 per cent to Hodges and 5 per cent to DeLaughter (R. 118-119, 455-457). These profit-sharings were set up on the books of the company for 1941 on or about the 15th day of February, 1942, and the amounts thereof credited to the employees' accounts (R. 108-110). The profits were split for 1942 on or about February 15, 1943, pursuant to previous agreement in the preceding year as to percentages between employees (R. 118-119) through the same process. Each employee was immediately notified in each instance of these credits established and each was told that he was free, if he desired, to withdraw the amount (R. 110, 119, 160, 164, 179, 186, 212-213) and at all times thereafter each of such employees was wholly free to withdraw any or all of the amount standing to his credit. This remained true at all times up to the time of the formation of the partnership in 1943 (R. 212, 368-369, 160, 164, 180, 493).

In making this division of profits and distribution it was not intended that such should constitute payment of additional compensation to the employees for services rendered only during the respective years 1941 and 1942. The profit-sharing was for additional compensation for services rendered since 1936 by such employees respec-

tively throughout the entire time of their respective employments. Each of such employees so understood it (R. 486, 218, 223, 225, 230). Any and all withdrawals made or which might have been made by the employees would have been effective, and C. C. Cooke was able at all times to have paid the amount thereof, being at all times in possession of cash and liquid assets sufficient to cover same (R. 212, 368-369, 493).

The arrangement for the profit-sharing was a reasonable and customary arrangement in the contracting business under the circumstances experienced by the taxpayer, C. C. Cooke, Sr. (R. 245, 237-238, 261-262, 249-250). The key employees with whom the profit-sharing arrangement was made were intimately known and carefully watched and observed in the course of their actual work by several outsiders who testified and who were completely disinterested persons and over a period of years (R. 238-240, 243-245, 250-257, 257-261, 248). In all of the jobs performed by C. C. Cooke, Sr., and during the war years and whether those jobs were the sole responsibility of C. C. Cooke, Sr., or had been let to a joint adventure of which C. C. Cooke, Sr., was a member, the employees of C. C. Cooke, Sr., were always the ones who took the responsibility for the jobs and who satisfactorily performed them under any and all conditions, even the most difficult (R. 118, 215-219, 223-225, 228, 233-236, 251-255, 248-249, 257-263). No other employees of any other contractor or construction company or roofing company mentioned in the testimony were comparable to those of C. C. Cooke, Sr. (R. 263-264, 258, 253, 255). The key employees of C. C. Cooke, Sr., did not receive

in regular salaries, wages and bonuses anything like their true worth (R. 218-219, 225) and in fact were worth to C. C. Cooke, Sr., doing business as C. C. Cooke Company, more than they actually received including their respective shares in the profit-sharing (R. 218-219, 192-193).

SPECIFICATIONS OF ERROR

1. The Court of Appeals erred in finding and holding that the profit-sharing agreement was unenforceable for each of the years 1941 and 1942.

2. The Court of Appeals erred in finding and holding that inferences drawn from inferences furnished substantial evidence to support the judgment of the Tax Court on the proft-sharing issue for each of the years 1941 and 1942.

3. The Court of Appeals erred in affirming the judgment of the Tax Court on the profit-sharing issue for each of the years 1941 and 1942, since as to each the judgment of the Tax Court is unsupported by sufficient evidence and is contrary to the uncontradicted evidence.

4. The Court of Appeals erred in refusing to pass upon and decide and uphold the contention of petitioner that he is entitled to credit, in any event, for taxes paid on his income for the years in question by the use of his money.

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Appeals for the Tenth Circuit in this cause, without citing any authority for its support upon the contract issue, is in direct conflict with

decisions of Courts of Appeals of other circuits as follows: (a) upon the validity and enforceability of the profit-sharing agreement, with *Flood* v. *U. S.* (C. A. 1, 1943), 133 F.2d 173; *Brampton Woolen Co.* v. *C. I. R.* (C. A. 1, 1930), 45 F.2d 327; *Helvering* v. *J. L. Brandeis & Sons* (C. A. 8, 1935), 75 F.2d 487; *Willoughby Camera Stores* v. *C. I. R.* (C. A. 2, 1942), 125 F.2d 607; *Knapp* v. *Imperial Oil & Gas Products Co.* (C. A. 4, 1942), 130 F.2d 1; (b) upon the reasonableness of the agreement and the profit-sharing compensation, with *C. I. R.* v. *Surface Combustion Corporation* (C. A. 6, 1950), 181 F.2d 444; *Lincoln Electric Co.* v. *C. I. R.* (C. A. 6, 1947), 162 F.2d 379; *Wm. S. Gray & Co.* v. *U. S.* (Ct. Cl., 1925), 35 F.2d 968; *Austin* v. *U. S.* (C. A. 5, 1928), 28 F.2d 677; (c) upon the point that part of the profit-sharing was compensation deferred, with *Mayson Mfg. Co.* v. *C. I. R.* (C. A. 6, 1949), 178 F.2d 115; *Taylor-Logan Co.* v. *White* (C. A. 1, 1933), 65 F.2d 994; (d) upon the point that the income was really that of the employees in the first instance and not that of petitioner, with *Cohen* v. *C. I. R.* (C. A. 4, 1929), 31 F.2d 874; *Pearsall* v. *U. S.* (Ct. Cl., 1931), 52 F.2d 1050; (e) upon the point that substance and not form controls, with its own previous decision in *Jones* v. *Grinnell* (C. A. 10, 1950), 179 F.2d 873; (f) upon the point of double taxation, with *Forman* v. *C. I. R.* (C. A. 9, 1952), 199 F.2d 881; and (g) upon the disregard of uncontradicted evidence, with *Capitol-Barg Co.* v. *C. I. R.* (C. A. 6, 1942), 131 F.2d 712; *Pittsburgh Hotels Co.* v. *C. I. R.* (C. A. 3, 1930), 43 F.2d 345; *Crude Oil Corporation of America* v. *C. I. R.* (C. A. 10, 1947), 161 F.2d 809.

2. The decision of the Court of Appeals for the Tenth Circuit disregards applicable local law (15 O. S. 1941,

Sec. 70, 75, see Appendix) on the validity and enforceability of the profit-sharing agreement and is in conflict with the effect of applicable local decisions on this point. By Oklahoma law the contract was valid, mutual and enforceable from the first moment services were rendered to petitioner under it. See *Stallings* v. *McIntire* (1947), 198 Okla. 551, 179 P.2d 907; *Western Bty. Supply Co.* v. *Duart Sales Co.* (1943), 192 Okla. 6, 133 P.2d 202; *Petroleum Research Corp.* v. *Barnsdall Rfg. Co.* (1940), 188 Okla. 62, 105 P.2d 1047; *Danzinger* v. *Geo. W. Ralls Co.* (1930), 144 Okla. 1, 288 Pac. 975; *Livingston* v. *Blair* (1924), 104 Okla. 238, 231 Pac. 82; *Conkling's Estate* v. *Champlin* (1943), 193 Okla. 79, 141 P.2d 569.

3. The Court of Appeals of the Tenth Circuit has decided federal questions in a way probably in conflict with applicable decisions of the Supreme Court, as follows: (a) upon the point that local law controls the enforceability of the profit-sharing contract, with *Lang* v. *C. I. R.* (1938), 304 U. S. 264, 82 L. Ed. 1131; (b) upon the validity and reasonableness of profit-sharing as deferred compensation, with *Lucas* v. *Ox Fibre Brush Co.* (1930), 281 U. S. 115, 74 L. Ed. 733; (c) upon the time of accrual of petitioner's liability, with *Continental Tie & Lumber Co.* v. *U. S.* (1932), 286 U. S. 290, 76 L. Ed. 1111; (d) upon the point of custom and usage in connection with profit-sharing, with *Lilly* v. *C. I. R.* (1952), 343 U. S. 90, 96 L. Ed. 769; (e) upon the point that substance and not form controls, with *C. I. R.* v. *Court Holding Co.* (1945), 324 U. S. 331, 89 L. Ed. 981; and (f) in refusing to pass upon and decide, and thus denying, the credit claimed by petitioner for taxes actually

paid with petitioner's funds, with *Bull* v. *U. S.* (1935), 295 U. S. 247, 79 L. Ed. 1421.

4. The Court of Appeals has sanctioned such a departure by the Tax Court from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. It has sanctioned the substitution for evidence of a dispelled presumption, speculation, conjecture and suspicion to overcome a positive, airtight case made by petitioner by clear-cut, competent and uncontradicted testimony and evidence adduced by petitioner. While affirming the Tax Court, the Court of Appeals indicates strongly in its two opinions (R. 558, 559, 561, 562, 602), that in many respects the findings of the Tax Court are completely unjustified, and in other vital respects only supported by "inference." Petitioner submits that such "inferences" could only have been drawn from other "inferences," themselves improperly and insufficiently established, which, of course is uniformly judicially forbidden. See *Helvering* v. *Taylor* (1935), 293 U. S. 507, 515, 79 L. Ed. 623, 629; *Del Vecchio* v. *Bowers* (1935), 296 U. S. 280, 285, 80 L. Ed. 229, 232; *U. S.* v. *U. S. Gypsum Co.* (1948), 333 U. S. 364, 92 L. Ed. 746.

CONCLUSION

The writ prayed for should be granted. A brief in support hereof is annexed to this petition, to which reference is here made.

Respectfully submitted,

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May, 1953.

APPENDIX

Internal Revenue Code:

Sec. 22. GROSS INCOME.

(a) General definition. — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1946 Ed., Sec. 22.)

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) (As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Statutes 798) Expenses.—

(1) Trade or business expenses.—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

(26 U. S. C. 1946 Ed., Sec. 23.)

[APPENDIX]

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.23 (a)-6. Compensation for personal services.—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. * * *

(2) * * * Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid. * * *

Sec. 19.41-1. Computation of net income.—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. * * *

Sec. 19.43-1. "Paid or incurred" and "paid or accrued." * * * The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which

"paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. * * *

15 Oklahoma Statutes 1941, Sec. 70:

"Performance of the conditions of a proposal, or the acceptance of the consideration offered with a proposal, is an acceptance of the proposal. (R. L. 1910, § 915.)"

15 Oklahoma Statutes 1941, Sec. 75:

"A voluntary acceptance of the benefit of a transaction is equivalent to a consent to all the obligations arising from it so far as the facts are known, or ought to be known to the person accepting. (R. L. 1910, § 920.)"

BRIEF

Except for emphasis or by inadvertence, petitioner does not herein cite again cases cited in the foregoing petition. But the explanation, argument and additional authorities herein may be helpful.

I.

The agreement which petitioner made, whether treated as an agreement for deferred and contingent compensation, or as an agreement for a joint adventure, was valid and enforceable under and by Oklahoma law and generally.

An actual, binding and legally enforceable obligation arose out of Cooke's commitments based upon considerations valid both in law and in equity (Sections 70-75, 15 Okla. Stats. 1941—Appendix).

Over long years the four key employees had performed services. From the inception the benefits had been accepted by Cooke. There had been offer, acceptance, consideration, mutuality, sufficient definiteness and performance (Statement of Case). From all jurisdictions, both Federal and State, the books are replete with cases that the type of contract here made was and is binding and enforceable. Among the leading cases are *Scott* v. *Duthie,* 125 Wash. 470, 216 Pac. 853 (28 A. L. R. 328, 338); *Fruth* v. *Gaston* (Tex. Civ. App.), 187 S.W.2d 581; *Geo. A. Fuller* v. *Brown,* 15 F.2d 672 (C. A. 4); *Herman* v. *Golden Arrow Dairy,* 191 Wash. 582, 71 P.2d 581; *Meyerson* v. *N. I. Hosiery Co.,* 217 Ala. 153, 115 So. 94; *Warren* v. *Mosher,* 31 Ariz. 33, 250 Pac. 354; *Dyke* v. *Stokes,* 168 Ark. 943, 272 S. W. 663; *Home*

Equipment Co. v. *Gorham,* 218 Ind. 454, 33 N.E.2d 99; *Zampatella* v. *T.-C. Shoe Co.,* 249 Mass. 87, 144 N. E. 82; *Wellington* v. *C. P. C. P. Co.,* 216 Mo. App. 358, 268 S. W. 396; *Gray* v. *T. N. B. M. Co.,* 259 App. Div. 783, 18 N.Y.S.2d 525; *La Juett* v. *C. M. Co.,* 153 Misc. 410, 275 N. Y. S. 822; *Harding* v. *Montgomery Ward Co.* (Ohio App.), 58 N.E.2d 75; *Swanson* v. *A.-R. T. Co.,* 52 S. D. 113, 216 N. W. 867; *Kollman* v. *McGregor,* 240 Iowa 1331, 39 N.W.2d 302; *Pyeatt* v. *El Paso Natural Gas Co.,* 54 N. M. 70, 213 P.2d 436; *Chew* v. *Leonard,* 228 N. C. 181, 44 S.E.2d 869.

II.

As an agreement for deferred and contingent compensation the arrangement was valid and enforceable and the profits shared for 1941 and 1942 were deductible as "expense incurred" in those years under Title 26, Sec. 23(a).

The deferred compensation in this case is contractual and not gratuitous, made in advance of the service, contingent in certain ways as to time and amount, and was finally paid in each instance as the result of a contract wholly and fully performed.

The record is uncontradicted to the effect that the petitioner honestly determined that the agreement he made with his key employees was necessary, reasonable and required for the conduct of his business (R. 214). Disinterested witnesses (four) of highest character, credibility and qualifications testified that such an arrangement was essential and customary (R. 237, 245, 249, 261). Neither the Commissioner nor the Court could properly overrule the

honest business judgment of the petitioner as to his requirements in the conduct of his business.

The payments made in 1941 and 1942 were retroactive as far back as 1936, but there is nothing unusual or invalid in paying compensation for services in a year subsequent to that in which the services were rendered. *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115, 119, 74 L. Ed. 733; *Amer. Rolling Mill Co.* v. *Commissioner* (C. A. 6), 41 F.2d 314; *Frazer* v. *Commissioner* (C. A. 6), 157 F.2d 782; *United States* v. *Cummins Dist. Corp.* (C. A. 6), 166 F.2d 17, 20; *Riddlesbarger* v. *C. I. R.* (C. A. 7), 200 F.2d 165.

III.

Looking to substance rather than form (as required), the arrangement was valid and enforceable as a "joint adventure," requiring division of profits, with 50% to be distributed to the key employees on a reasonable basis between themselves, as joint adventurers with the employer, Cooke, Sr.

A joint adventure is a special combination of two or more persons where in some specific venture a profit is jointly sought without any actual partnership or corporate venture. *Commercial Lumber Co.* v. *Nelson*, 181 Okla. 122, 72 P.2d 829; *U. S. F. & G.* v. *Dawson Produce Co.*, 200 Okla. 540, 197 P.2d 978; *Madwine* v. *Osage Supply Co.*, 177 Okla. 200, 58 P.2d 131.

The Commissioner and the Courts below saw fit to disallow the profit sharing as expense deductions, obviously upon the theory that they were not "compensation" but amounted to unauthorized "distributions of earnings." If, for any reason, it can be said that the distributions made

cannot be allowed as *deductible expenses,* then we assert that they were authorized and legally proper as "distribution of profits of a joint adventure" to those entitled thereto. *Rupple* v. *Kuhl* (C. A. 7), 177 F.2d 823; *Barnes* v. *Alexander,* 232 U. S. 117, 58 L. Ed. 530.

Under the law, and particularly that of Oklahoma, believed controlling here, there could be no doubt but that 50 per cent of the profits for 1941 and 1942 were properly distributable as such to the key employees, as joint adventurers with Cooke, and thus not income to petitioner or taxable to petitioner at all. *Greenwood* v. *C. I. R.* (C. A. 9), 134 F.2d 915. So that regardless of whether they might not, collectively or in any one or more instances, be deductible as expense, the end result is the same as if they were. The mere form of the report by the taxpayer upon a different basis, as the result of a misconception of law or choice of words, would not alter the substance of the matter which the law requires shall be controlling.

IV.

Sworn positive testimony of many witnesses cannot be lightly disregarded, and the Court is bound by the evidence. Capitol-Barg Co. v. C. I. R. (C. A. 6), 131 F.2d 712.

We submit that in this case the sworn positive, uncontradicted, unimpeached testimony of many witnesses has been disregarded and ignored, and the courts below have sustained the theory of the Government upon a fabrication of suspicions and conclusions contrary to the evidence. In its original decision (R. 562) the Court of Appeals

said with reference to some of the evidence upon which the Tax Court based its findings:

> "We think it sufficient to say that most of these appear to be trivial and not at all unusual in dealings between persons associated together as these men were. Many of the discrepancies were explained and others relied upon were not actually contrary to the partnership relation and did not show any lack of good faith between the parties."

In the opinion on rehearing (R. 602) the Court of Appeals said:

> "We have no doubt but that there was evidence which would sustain a finding that there was such a contract, but the Tax Court found otherwise * * *. We think there is sufficient evidence in the record from which a lawful inference may be drawn that there was no enforceable contract requiring a division of the profits for the years 1941 and 1942."

Petitioner asserts that nothing but suspicion, trifles, speculation and guesswork could be the basis of such an inference. Petitioner's evidence was direct, positive and uncontradicted.

Evidence may not be entirely rejected unless (1) it has been shown to have been deliberately falsified in some material respect, (2) it is contradicted completely by evidence of like dignity and kind, or (3) it is inherently improbable or so at war with possibilities as to be unworthy of belief. *Dempster Mill Mfg. Co.* v. *Burnett, C. I. R.* (C. A. D. C.), 46 F.2d 604.

The initial presumption which aids the action of the Commissioner in making deficiency assessments is one of law rather than inference of fact, and such presumption disappears when sufficient evidence to sustain a contrary finding has been introduced. *British-America Assurance Co.* v. *Bowen* (C. A. 10), 134 F.2d 256, 259; *Lawrence* v. *C. I. R.* (C. A. 9), 143 F.2d 456, 459; *Cooperative Pub. Co.* v. *C. I. R.* (C. A. 9), 115 F.2d 1017, 1021; *Wiget* v. *Becker, C. I. R.* (C. A. 8), 84 F.2d 706, 708.

It will be noted that the Tax Court specifically found (R. 76-77) that the petitioner was guilty of no fraud. In the very nature of things such finding is conclusive of the existence of the necessary intent, good faith, substance, and reality of the existence of the profit-sharing agreement, and refutes any finding that the profit-sharing agreement was non-existent and ineffective. Any doubt must be resolved in favor of the taxpayer. *Allen* v. *Atlanta Metalic Casket Co.* (C. A. 5), 197 F.2d 460.

V.

The evidence is insufficient to support the decision of the Tax Court with respect to the profit sharing for 1941-1942 or to overcome the strong and positive proof made by petitioner with respect thereto.

The long, rambling, confusing opinion of the Tax Court is the result of disregard of uncontradicted evidence and the substitution of suspicion as a basis for rationalization.

The memorandum opinion (R. 25-77) clearly evidences that form and not substance has controlled the decision. The process of reaching a conclusion has obviously

been one of following "lines of measurement," themselves traced on the pattern book by technical legal specifications. Reiteration by the Tax Court of recitals of deviation by petitioner from legal pattern accentuates the rigidity of the formal requirements used as the "measuring stick." The law requires that substance and not form shall control and that legal and equitable relationships, valid and enforceable under local law, shall not be ignored or held unreal.

The Tax Court, and later the Court of Appeals, holds that satisfaction of legal liability is unreal and fantastic (R. 59). This will not do. The law of Oklahoma dealing with "common enterprise" and "unjust enrichment," both of which required sharing of profits in 1941 and 1942 cannot thus be ignored.

The Court of Appeals fell into grievous error when it found that the taxpayer relied upon the same evidence for a division of profits for 1942 as he did for the year 1941. The record conclusively shows that as to the year 1942 a stronger agreement prevailed for the reason that in the year 1941 and prior to the taxable period a supplemental agreement was reached fixing definitely in terms of percentages the amount that each of the key employees was to get (R. 109, 118, 589, 595).

VI.

Uncontradicted evidence required, as minimum relief to the taxpayer, that credits be allowed to the taxpayer for each of the years involved (1941-1942) to the extent of income taxes paid by the key employees for those years on account of profit sharing or deferred compensation.

The point presented here and upon which petitioner strongly relies in the alternative, was presented to the Tax Court in the Petition (R. 10) by the proof (R. 30, 34, 419, 424, 460) and in and by petitioner's computation under Rule 50 of the Tax Court (R. 84-87). But no attention was paid to it by the Tax Court whatsoever. It was again urged to the Court of Appeals (Brief of Petitioner, 61-66), and thereafter presented in the Petition for Rehearing (page 17), all to no avail.

Petitioner here seriously and earnestly urges the point again. Formal waivers from the employees will adequately protect the government. Law, equity, good sense, common morality, fair dealing between government and citizen and even the fundamental concept of the tax laws of the United States all indicate that the point is well taken.

In the memorandum opinion herein, the Tax Court holds (R. 58-59, 71) that no real distributions of profits were made by Cooke to his employees for 1941-1942, and that the credits set up on the books for the employees for those years were unreal, and that the income represented thereby did not belong to the employees, but to Cooke, Sr., and was at all times the property of Cooke, Sr. The Court notes in its opinion (R. 30) that for each of the years in question, the employees mistakenly returned for federal

income taxation as income to them, in the respective years, the amounts credited on the books to their respective accounts, the Court saying (R. 34, 30): "The tax on the net income reported by each key employee to the State of Oklahoma and to the Federal Government for the years 1941-1942 * * * was paid by check of the Company and charged to his account."

Thus, it is perfectly obvious that the Tax Court (affirmed by the Court of Appeals) *held that the said key employees, to the extent of the credits set up in their accounts respectively, have paid federal income taxes upon the income of C. C. Cooke, Sr., with money belonging to C. C. Cooke, Sr., with his consent, for each of the years in question* (R. 34, 30, 42, 69).

This being true it is urged that the court below should have directed, at the very minimum, that the amount so paid by the key employees for the years in question, on account of said amount so erroneously returned by them, be allowed to C. C. Cooke, Sr., as a credit upon his taxes. Nothing less could possibly do right, give effect to petitioner's legal rights, or do any kind of equity to the taxpayer. The rule that an action will lie whenever defendant has received money which is property of the plaintiff which the defendant is obliged by natural justice and equity to refund is applicable to the United States as well as to individuals. *Bull* v. *U. S.*, 295 U. S. 247, 79 L. Ed. 1421; *U. S.* v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189, 44 Sup. Ct. 546.

This issue is vital, important, substantial and real. It has never been waived, abandoned, or neglected, and

has been urged with force at every opportunity by the petitioner. Figuratively speaking, he has pleaded in Gath and petitioned in Ascalon believing that he was entitled as a matter of right and of law to a determination of this important question in the light of the holdings in the cases cited and many others. To date, the only answer thus far given is—stony silence. This is error *per se. Maryland Casualty Co.* v. *Jones,* 279 U. S. 792, 73 L. Ed. 960.

It is respectfully submitted that the petition should be granted.

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May, 1953.

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 77

C. C. COOKE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 25-77) are not reported. The opinion of the Court of Appeals (R. 555-562) is reported at 203 F. 2d 258.

JURISDICTION

The judgment of the Court of Appeals was entered January 3, 1953. (R. 562-563.) A petition for rehearing was denied April 14, 1953. (R. 602-603.) The petition for certiorari was filed May 18,

1953. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

The ultimate question presented is whether the Court of Appeals was correct in holding that the Tax Court, on the whole record, was warranted in concluding (1) that no agreement was entered into by the taxpayer with his key employees during or prior to the tax year 1941 to pay to them for that year, in addition to their regular salaries and bonuses, certain amounts for services based on the taxpayer's profits in that year, and (2) if the taxpayer did so agree, whether the amounts credited to the employees, respectively, for that purpose, were in excess of reasonable compensation for the services rendered within the meaning of Section 23(a)(1)(A) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved appear in the Appendix, *infra,* pp. 11-12.

STATEMENT

The facts as found by the Tax Court may be summarized as follows:

This case originally involved deficiencies of income taxes and fraud penalties for the years 1941, 1942, and 1943 [1] (R. 25).

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[1] The Tax Court determined deficiencies in petitioner's income taxes for the years 1941 and 1943, but found no deficiency for the year 1942 (R. 87). The Tax Court also held that fraud had not been proved (R. 77). The Court of Appeals reversed the Tax Court with respect to the 1943 deficiency (R. 563).

Petitioner (the taxpayer) has been engaged in roofing and sheet metal work for commercial buildings since 1908, and since about 1930 he has operated under the trade name of C. C. Cooke Co. (R. 26). In 1930 petitioner had two key employees, J. C. Leister [2] and C. E. Hodges. In 1933 petitioner hired another key employee, J. P. Ground. In 1935 or 1936 petitioner's son, Clint C. Cooke, Jr., became a key employee, and in 1939 Charles H. DeLaughter became a key employee. (R. 27.)

The total straight salaries paid to the key employees from 1937 to 1941, inclusive, were as follows (R. 28):

Year:	Ground:	Hodges:	Cooke, Jr.:	DeLaughter:
1937.....	$2,080.00	$2,111.89	$ 900.00	
1938.....	2,390.00	1,896.50	1,275.00	
1939.....	2,650.00	2,275.00	1,300.00	$1,150.00
1940.....	2,650.00	2,716.00	3,925.00	1,614.00
1941.....	2,600.00	3,146.25	5,200.00	2,127.59

In addition to the above salaries, Ground and Hodges received bonuses from C. C. Cooke Co. in the amounts of $3,900 and $750, respectively, for 1941.

Hodges started to work for petitioner in 1928 as a sheet and metal apprentice. Thereafter he worked as a mechanic, or roofer, and did other work assigned to him, including supervision of construction projects. He was a willing worker and at times worked long hours. (R. 28.)

Ground started as a laborer, in 1939, and thereafter he prepared estimates for jobs, made up lists

---

Hence, the only issue presented here is that involving the income tax deficiency determined by the Tax Court for the year 1941.

[2] Payments to Leister are not involved (R. 29, note).

of materials to be purchased, supervised operations in the plant, took measurements for and acted as superintendent of projects, supervised the fabrication of material, and was in general charge of the company's business in the absence of petitioner. (R. 28-29.)

Cooke, Jr. studied engineering at college for two and one-half years. He started to work at odd times for petitioner when he was very young. He accompanied his father to Honolulu in 1939 and while there took charge of jobs. Upon his return from Honolulu in 1940, he was placed in charge of contracts at Ft. Riley and Camp Gruber. His services were similar to those performed by Ground (R. 29).

DeLaughter's duties consisted of keeping the company's books and records, doing stenographic work, and other necessary work that he could perform (R. 29).

The key employees were at all times paid salaries and bonuses comparable with those paid by other organizations similar to that of petitioner (R. 29).

In July, 1941, petitioner requested DeLaughter to ascertain whether applicable revenue acts prohibited petitioner from obtaining deductions for amounts that he might distribute under a plan to share profits of his business with his key employees. DeLaughter informed petitioner that he found nothing against the deductibility of amounts paid under a plan of that character. (R. 29-30.)

The company had profits in 1941 amounting to

$126,456.66 [3] (R. 30). In 1942, after DeLaughter had determined the earnings of the company for 1941, petitioner directed DeLaughter to credit 20 per cent of the total profits for 1941 to the accounts of Cooke, Jr., and Ground, respectively, and 5 per cent to Hodges and DeLaughter. The next day petitioner directed that the account of Hodges be increased to 10 per cent and that the 5 per cent credit to DeLaughter's account be eliminated. Appropriate entries were made in the books, charging salary expenses with the credits of $63,228.34 ordered by petitioner. The explanation for the entries classified the amounts as distributions of profit in accordance with an agreement of January 1, 1941, without any statement that they constituted additional compensation for services of prior years. (R. 30.)

The key employees reported the credited amounts for personal income tax purposes on the cash basis. They reported such amounts as income received for personal services. The returns were prepared by DeLaughter (R. 30), and the tax on the net income reported by each key employee for the year 1941 was paid by check of the company and charged to his account (R. 34).

In his tax return for the year 1941, petitioner claimed as deductions the amounts which had been

---

[3] For the years 1931 to 1940, inclusive, the company had had the following profits or losses (R. 27):

1931	$3,733.42	1936	$ 5,361.33
1932	3,820.01 (loss)	1937	6,834.36
1933	3,991.48 (loss)	1938	10,202.99
1934	4,208.87	1939	10,861.74
1935	6,336.04	1940	5,260.95

credited to the key employees' accounts. The Commissioner allowed $5,200 as salary for Cooke, Jr., $4,928.75 for salary and bonus for Grounds, $3,146.25 for Hodges, and $1,827.59 for DeLaughter, a total of $15,102.59, and disallowed the remainder of the $63,228.34 credits on the ground that the entries made for the amounts "were made solely for the purpose of avoiding income tax and not for the purpose of setting up bona fide credits to your employees." The Commissioner also took the position that if the credits were bona fide the amounts constituted excessive compensation. (R. 33.)

The Tax Court determined deficiencies in petitioner's income taxes for the years 1941, and 1943, in the amounts of $46,239.86 and $70,995.51, respectively (R. 87), finding that there had been no prior agreement to divide the profits of the company, and that in any event the amounts credited to the key employees constituted excessive compensation (R. 37). The Court of Appeals affirmed the decision of the Tax Court with respect to the tax year 1941, but reversed it with respect to the deficiency determined for the year 1943.[4]

ARGUMENT

The issue whether petitioner entered into an agreement with his key employees prior to or during 1941 to divide the profits of the company with them, and if he did so whether the amounts credited to their accounts constituted reasonable compensa-

[4] As we have shown in footnote 1, *supra*, p. 2, the deficiency for the year 1943 is not involved here.

tion for services rendered within the purview of Section 23(a)(1)(A) of the Internal Revenue Code, *infra*, p. 11, obviously presents questions of pure fact, and both courts below have concurred in the findings made. The settled rule of this Court makes concurrent findings of two courts below final here in the absence of exceptional error. *Comstock* v. *Group of Investors*, 335 U.S. 211-214. The findings made in this case are reasonably supported by the record, and petitioner has failed to demonstrate that exceptional error was committed. In the circumstances, no important question of law is presented which warrants review by this Court.

1. Petitioner contends, in effect, that there was no evidence to support the Tax Court's finding that there was no agreement prior to or during 1941 between petitioner and his key employees to share the profits of the company. The contention is without merit.

The burden was on petitioner to justify the deductions which he had taken and which had been disallowed. *Welch* v. *Helvering*, 290 U.S. 111, 115; *Pearce* v. *Commissioner*, 315 U.S. 543, 546. His evidence consisted of vague and inconsistent testimony that in and subsequent to 1936 petitioner had orally informed his key employees, in effect, that if they remained in his employ at the compensation then being paid to them for their services, profits of the business would be shared with them on the basis of their effort when the company could pay it (R. 46). There was nothing in the testimony that the early statements contained anything concerning the

percentage of the profits the employees would receive (R. 49), or that the statements were intended to have any binding effect. The alleged oral agreement was reduced to writing only in March of 1943, and after the examination of petitioner's income tax return for 1941 had begun (R. 48). The Tax Court was not obliged to accept as true petitioner's statement of his intention and purpose. *Helvering* v. *National Grocery Co.*, 304 U.S. 282, 295. Inconsistencies in petitioner's evidence are pointed out and discussed in the Tax Court's opinion (R. 49-50).

There was also other evidence which clearly demonstrated that the alleged statements made by petitioner to his employees were not intended to be binding. For example, petitioner obvously did not consider that he was obligated to share the profits of 1941 with DeLaughter, for after directing that DeLaughter be credited with 5 percent of the profits for 1941, he changed his mind and withdrew the credit (R. 50). Many other items of evidence which support the conclusion that there was no enforceable profit-sharing agreement between petitioner and his key employees prior to or during 1941, are painstakingly discussed in the Tax Court's exhaustive opinion (R. 50-65). On the whole record, the court below was warranted in holding that the Tax Court was amply justified in finding that there was no profit-sharing agreement which obligated petitioner to share with his key employees his 1941 profits.

2. The court below was likewise warranted in holding that the Tax Court properly found that the

amounts credited to the key employees from the 1941 profits, were excessive and did not constitute reasonable compensation within the meaning of Section 23(a)(1)(A) of the Internal Revenue Code, *infra*, p. 11.

Petitioner's key employees were at all times paid salaries and bonuses comparable with those paid by other organizations similar to that of petitioner. The very large amounts credited to them under the alleged profit sharing agreement were thus entirely out of proportion to the compensation received by the employees of others who rendered the same character of service. Cooke, Jr. and Ground, for example, were each credited with $53,033.16, while the regular annual salary paid for service such as they rendered was $2,600.00. In addition Ground also received a Christmas bonus of $4,375.00 (R. 35).

Petitioner makes an apparent effort to overcome the effect of the excessively large amounts credited to the key employees in the alleged profit-sharing arrangement for the service they rendered, by contending that the compensation was in fact for the service rendered by them during the prior years when they were rendering valuable service for modest salaries in anticipation of the profit-sharing day to come. But viewing the evidence in a manner most favorable to petitioner, there was no binding obligation on him at any time to share the 1941 profits with the employees, for the alleged agreement was so vague and indefinite as to lack vitality.

Petitioner also endeavors to avoid the unreason-

able-compensation issue by asserting that the alleged profit-sharing agreement was a joint venture. Obviously, there is no merit to this contention, since, as the court below stated (R. 559), it is clear from the evidence that the relationship of the parties was, prior to and during 1941, that of employer and employee.

CONCLUSION

The decision of the court below is correct, and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JUNE, 1953.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.23(a)-6. *Compensation for personal services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

* * * * *

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

The provisions of Section 29.23(a)-6 of Treasury Regulations 111, promulgated under the Internal Revenue Code, are substantially the same.

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